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Message Text

UNCLASSIFIED

PAGE 01 LONDON 08999 01 OF 05 071745Z
ACTION EUR-12

INFO OCT-01 EA-12 IO-14 ISO-00 AID-05 CIAE-00 EB-08
FRB-01 INR-10 NSAE-00 ICA-20 XMB-04 OPIC-06 SP-02
LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07 CEA-01
L-03 H-02 AGRE-00 PA-02 /136 W
----------098956 071838Z /45
P R 071734Z JUN 78
FM AMEMBASSY LONDON
TO SECSTATE WASHDC PRIORITY 6918
TREASURY DEPT WASHDC PRIORITY
INFO AMEMBASSY BONN
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AMEMBASSY PARIS
AMEMBASSY ROME
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UNCLAS SECTION 01 OF 05 LONDON 08999

USEEC ALSO FOR EMBASSY
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DEPARTMENT PASS FEDERAL RESERVE BOARD; TREASURY FOR
DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: ECON, UK
SUBJECT: ECONOMIC DEVELOPMENTS FOR PERIOD JUNE 1 - 7

SUMMARY: THE ELIGIBLE LIABILITIES OF THE BANKING SECTOR INCREASED 1.4 PERCENT IN THE MAY BANKING MONTH. FEARS OF
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PAGE 02 LONDON 08999 01 OF 05 071745Z

EXCESSIVE GROWTH IN THE MONETARY AGGREGATES REACHED THE PRESS WHO, ALONG WITH FINANCIAL MARKET SOURCES, EXPECT AND ENCOURAGE A PACKAGE OF MEASURES TO CONTROL MONETARY GROWTH SOON. UNCERTAINTY OF MONETARY TRENDS PROVED UNSETTLING TO THE FOREIGN EXCHANGE MARKET. THE FINAL ESTIMATE OF APRIL RETAIL SALES VOLUME SHOWED AN 0.3 PERCENT DECLINE FROM THE MARCH LEVEL. HIRE PURCHASE AND INSTALL-

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

MENT DEBT INCREASED 93 MILLION POUNDS IN APRIL. THE FINANCIAL TIMES SURVEY OF BUSINESS INTENTIONS SEES SKILLED LABOR SHORTAGES BECOMING MORE SEVERE. THE LONDON CLEARING BANKS ADVANCES TO THE PRIVATE SECTOR INCREASED 307 MILLION POUNDS IN MAY. OFFICIAL RESERVES FELL 377 MILLION DOLLARS IN MAY. THE DEPARTMENT OF INDUSTRY'S INVESTMENT INTENTIONS SURVEY CONTINUES TO INDICATE AN INCREASE OF BETWEEN 10 AND 13 PERCENT IN MANUFACTURING INVESTMENT IN 1978 OVER 1977. PUBLIC SECTOR BORROWING REQUIREMENT FOR THE LAST QUARTER OF THE 1977/78 FINANCIAL YEAR WAS VERY CLOSE TO THAT ESTIMATED IN THE CHANCELLOR'S

1. THE FIRST SEASONALLY ADJUSTED INDEX OF APRIL RETAIL SALES VOLUME WAS 106.7 (1971 EQUALS 100), CLOSE TO THE PROVISIONAL 106-1/2 ESTIMATE. THE INDEX AND SOME SUBSIDIES HAVE BEHAVED AS FOLLOWS OVER THE PAST FOUR MONTHS:

(SEASONALLY ADJUSTED 1971 EQUALS 100)

	JANUARY	FEBRUARY	MARCH	APRIL
ALL KINDS OF BUSINESS	104.9	106.8	107.0	106.7
FOOD SHOPS	95.1	96.8	97.6	96.5
CLOTHING & FOOTWEAR SHOPS	105	109	115	108
DURABLE GOODS SHOPS	129	130	117	132
OTHER NON-FOOD SHOPS	109	111	112	111

2. HIRE PURCHASE AND OTHER INSTALLMENT DEBT INCREASED MARKEDLY IN APRIL. THIS IS PRIMARILY ATTRIBUTABLE TO THE UNCLASSIFIED

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PAGE 03 LONDON 08999 01 OF 05 071745Z

INCREASE IN DEBT TO RETAILERS WHICH REGAINED THE LEVEL ESTABLISHED IN MARCH AND APRIL. THE STATISTICS OVER THE PAST FOUR MONTHS:

(MILLIONS OF POUNDS, SEASONALLY ADJUSTED)

	NEW CREDIT EXTENDED	CHANGE IN DEBT
JANUARY	429	85
FEBRUARY	418	82
MARCH	413	78
APRIL	463	93

3. IN ITS MOST RECENT SURVEY OF BUSINESS INTENTIONS, THE FINANCIAL TIMES STRESSES THE EMERGENCE OF SKILLED LABOR CONSTRAINTS AND THE DIFFICULTY OF FURTHER REDUCING UNEMPLOYMENT. IT NOTES AT THE SAME TIME THAT THE SURVEY RECORDS "A NOTABLE REDUCTION IN OPTIMISM ABOUT GENERAL BUSINESS PROSPECTS."

THE FT SURVEY, AS WITH OTHER SUCH SURVEYS, MUST HOWEVER BE VIEWED WITH SOME RESERVATION. THE REASONABLY VAGUE QUESTION ON BUSINESS OPTIMISM FOR EXAMPLE IS "ARE YOU MORE OR LESS OPTIMISTIC ABOUT YOUR COMPANY'S PROSPECTS THAN YOU WERE FOUR MONTHS AGO?" THE REPLIES IN THE TWO MOST RECENT PERIODS WERE:

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Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

	FEB-MAY	JAN-APRIL
	(PERCENT)	
MORE OPTIMISTIC	30	37
NEUTRAL	40	38
LESS OPTIMISTIC	26	25

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PAGE 01 LONDON 08999 02 OF 05 071757Z
ACTION EUR-12

INFO OCT-01 EA-12 IO-14 ISO-00 AID-05 CIAE-00 EB-08
FRB-01 INR-10 NSAE-00 ICA-20 XMB-04 OPIC-06 SP-02
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UNCLAS SECTION 02 OF 05 LONDON 08999

THE RESPONSES ARE CLEARLY CONSISTENT WITH SOME RISING, THOUGH DECELERATING, MEASURE OF OPTIMISM.

THE FT NOTES THAT RESPONDENTS HAVE FOR SEVERAL MONTHS CITED DIFFICULTIES OF RECRUITING EXECUTIVE STAFF, SKILLED FACTORY PERSONNELAND MANUAL LABOR. THE DIFFICULTY IS ATTRIBUTED TO TAX AND PAY POLICIES WHICH HAVE COMPRESSED WAGE DIFFERENTIALS AND REDUCED THE AFTER-TAX RETURN TO OVERTIME WORK.

AT THE SAME TIME, IT WAS NOTED THAT MORE FIRMS WERE

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EXPECTING TO DECREASE THEIR LABOR FORCE THAN IN THE PAST.
THE REASON FOR THIS DECLINE IS SAID TO BE FIRST, LACK OF
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PAGE 02 LONDON 08999 02 OF 05 071757Z

DEMAND, AND SECOND, A COMBINATION OF THE POTENTIAL COSTS
OF REDUNDANCY PAYMENTS AND PLANS TO RAISE PRODUCTIVITY.
IT MUST BE CAUTIONED AGAIN THAT IN SPITE OF THE FT'S
INTERPRETATION AND IN-DEPTH COMMENT, THE DISTRIBUTION OF
REPLIES IS CONSISTENT WITH RISING EMPLOYMENT. FOR THE
MOST RECENT PERIODS COVERED, THOSE RESPONDENTS "EXPECT-
ING THEIR LABOR OVER THE NEXT TWELVE MONTHS TO:

	FEB-MAY	JAN-APRIL
	(PERCENT)	
INCREASE	29	28
STAY ABOUT THE SAME	52	57
DECREASE	19	15".

4. THE ELIGIBLE LIABILITIES OF BANKS, A LARGE MONETARY
AGGREGATE USE IN CALCULATING RESERVE REQUIREMENTS, ROSE
1.4 PERCENT IN THE BANKING MONTH ENDED MAY 17, AFTER A
2.5 PERCENT RISE IN APRIL. THE SERIES IS NOT SEASONALLY
ADJUSTED AND ITS RELATION TO STERLING M3, THE AGGREGATE
IN TERMS OF WHICH THE GOVERNMENT'S MONETARY TARGET IS
SET, IS NOT STABLE. THE PRESS AND MARKET SOURCES, HOWEVE
INTERPRET THE DECELERATION AS POINTING TO LOWER STERLING
M3 GROWTH THIS MONTH. A SUMMARYOF THESE BANKING FIGURES:

	(MILLIONS OF POUNDS)	
	MAY 17	CHANGES ON THE MONTH
ELIGIBLE LIABILITIES	44,496	613
OF WHICH INTEREST BEARING	30,096	707
RESERVE ASSETS	6,195	87
OF WHICH		
BALANCES WITH THE BANK OF ENGLAND	351	- 4
MONEY AT CALL IN THE DISCOUNT MARKET	3,339	37
U.K. AND NORTHERN IRELAND		

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PAGE 03 LONDON 08999 02 OF 05 071757Z

TREASURY BILLS	918	75
RESERVE RATIO (PERCENT)	13.9	-

5. TOTAL LIABILITIES AND ASSETS OF THE LONDON CLEARING
BANKS ROSE BUT 207 MILLION POUNDS TO 61,778 MILLION
POUNDS DURING THE BANKING MONTH ENDED MAY 17. THIS IN-
CREASE WAS STRONGLY INFLUENCED BY INTERBANK TRANSACTIONS.

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STERLING DEPOSITS OF THE U.K. BANKING SECTOR AT THE CLEARERS FELL 572 MILLION POUNDS. IN A LIKE MANNER, MARKET LOANS BY THE CLEARERS TO U.K. BANKS FELL 411 MILLION POUNDS. STERLING ADVANCES TO THE U.K. PRIVATE SECTOR SHOWED A STRONG INCREASE OF 307 MILLION POUNDS TO 18,227 MILLION POUNDS.

6. OFFICIAL RESERVES OF THE U.K. FELL $377 MILLION IN MAY DURING THE MONTH RESERVE CHANGES WERE INFLUENCED BY A $345 MILLION ACCRUAL FROM THE ISSUE OF HMG OONDS IN THE NEW YORK CAPITAL MARKET, A $6 MILLION ACCRUAL OF FOREING CURRENCY BORROWING UNDER THE EXCHANGE COVER SCHEME AND $78 MILLION IN REPAYMENTS OF PUBLIC SECTOR DEBT UNDER THE EXCHANGE COVER SCHEME. RESERVES AT END MAY WERE $16,661 MILLION.

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PAGE 01 LONDON 08999 03 OF 05 080036Z
ACTION EUR-12

INFO OCT-01 EA-12 IO-14 ISO-00 AID-05 CIAE-00 EB-08
FRB-01 INR-10 NSAE-00 ICA-20 XMB-04 OPIC-06 SP-02
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AMCONSUL EDINBURGH
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UNCLAS SECTION 03 OF 05 LONDON 08999

C O R R E C T E D C O P Y (TEXT GARBLED THROUGHOUT)

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7. THE DEPARTMENT OF INDUSTRY'S (SECOND OF THREE) INVEST-
MENT INTENTIONS SURVEY INDICATES AN INCREASE OF BETWEE
10 AND 13 PERCENT IN MANUFACTURING INVESETMENT IN 1978 OVER
1977. THE SURVEY, TAKEN DURING MARCH AND APRIL, GIVES
BROADLY THE SAME RESULT AS THE FIRST SURVEY TAKEN AT THE
END OF 1977. THE DISTRIBUTION AND SERVICE SECTOR IS EX-
PECTED TO INCREASE ITS INVESTMENT BY 6 TO 8 PERCENT OVER
THE SAME PERIOD. THE HIGH LEVEL OF INVESTMENT IN THE DIS-
TRIBUTION AND SERVICE SECTOR, WHICH NOW EXCEEDS THAT IN
MANUFACTURING, IS THOUGHT TO REFLECT IN PART GREATER LEAS-
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PAGE 02 LONDON 08999 03 OF 05 080036Z

ING OF CAPITAL EQUIPMENT. THIS WOULD NOT AFFECT THE AG-
GREGATE BUT WOULD REDISTRIBUTE INVESTMENT OUTLAYS AMONG
SECTORS.

8. STERLING HAD AN UNSETTLED WEEK ALTHOUGH BUY AND SELL
ORDERS IN THE RANGE OF 5-10 MILLION POUNDS STERLING WERE
BEING TAKEN ON WEDNESDAY WITHOUT PARTICULAR IMOACT. DEAL-
ERS SAY THE BANK OF ENGLAND HAD BEEN INTERVENING EARLIER
IN THE WEEK IN THE $1.8170 RANGE. MONETARY TRENDS ARE
CONSIDERED A POTENTIAL THREAT, EXACERBATED BY THE STALE-
MATE BETWEEN INSTITUTIONS' UNWILLINGNESS TO BUY GILTS AND
THE GOVERNMENT'S APPARENT DETERMINATION NOT TO RAISE MLR.
THE SIZEABLE BANK OF ENGLAND SUPPORT FOR STERLING IN THE
CURRENT BANKING MONTH IS EXPECTED TO BRING IMPROVEMENT IN
M3, BUT AT A COST TO RESERVES THAT CANNOT BE LONG SUSTAIN-
ED. SOME DEALERS EXPECTED THE WIDENING OF FORWARDS. AT
LEAST ONE MAJOR BANK EXPECTS STERLING'S EFFECTIVE EX-
CHANGE RATE TO SLIP UNDER 60.0 OVER THE NEXT FEW WEEKS.

9. AS REPORTED IN PREVIOUS WEEKS, THE PROGRAM TO FUND
THE PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) CONTINUES
TO FACE DIFFICULTIES. WITH LITTLE DEMAND FOR NEW ISSUES OF
GILTS. FINANCIAL INSTITUTIONS, WITH HISTORICALLY HIGH
GILT-TOTAL ASSETS RATIOS, ARE APPARENTLY WILLING TO BUILD
UP LIQUIDITY INSTEAD OF ADDING GILTS TO THEI PORTFOLIOS,
AT LEAST IN THE CURRENT CONSTELLATION OF INTEREST RATES.
MAJOR MARKET ANALYSTS HAVE EXPRESSED EXTREME CONCERN OVER
THE FUNDING PROBLEMS AND THE IMPLIED DIFFICULTIES
OF MONETARY CONTROL. THEY HAVE A WIDE RANGE OF REMEDIAL
MEASURES, INCLUDING FOR EXAMPLE THE INTRODUCTION OF NEW
DEBT INSTRUMENTS, REIMPOSITION OF THE CORSET, AND ADDI-
TIONAL SHARP RISES IN INTEREST RATES.
DIFFICULTIES IN THE FUNDING PROGRAM, THE UNEXPECTED-
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Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

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LY LARGE GROWTH IN STERLING M3 DURING THE 1977/78 BANKING YEAR, AND THE RECENTLY RELEASED FIGURES ON ELIGIBLE LIABILITIES (PARAGRAPH 5) HAVE LED TO CONSIDERABLE COMMENT IN THE MAJOR PAPERS THIS WEEK. ARTICLES REMARK ON THE SUBSTANTIAL WKALBEIT LOWER THAN APRIL) GROWTH IN ELIGIBLE LIABILITIES EVEN AFTER MAJOR GOVERNMENT SUPPORT OF STERLING IN THE FOREIGN EXCHANGE MARKETS. THE LARGE LEVEL OF SEASONALLY UNADJUSTED BANK LENDING TO THE PRIVATE SECTOR IS MOREOVER CITED AS AN ITEM OF CONCERN, AS THIS ITEM USUALLY DECLINES IN THE MAY BANKING MONTH.

GENERALLY, THE PRESS ASSERTS THAT THE CHANCELLOR'S BUDGET DID NOT CONVINCINGLY RECONCILE THE HIGH PSBR WITH THE GOVERNMENT'S MONETARY TARGETS. TO ACHIEVE BOTH REQUIRES A VERY ACTIVE FUNDING PROGRAM. TO SET THE PSBR, A FLOW THAT IS ERRATIC AND EXTREMELY DIFFICULT TO PREDICT, CLOSE TT THE UPPER LIMIT CONSISTENT WITH RESPONSIBLE MONETARY GROWTH WAS TO TAKE A VERY LARGE RISK. THE SUNDING DIFFICULTIES HAVE MADE THIS PROBLEM MORE ACUTE, AND A MAJOR DEBATE IS REPORTED BY THE TIMES TO BE IN TRAIN BETWEEN THE BANK OF ENGLAND AND HMTREASURY OVER THE APPROPRIATE MEANS TO RESOLVE THE PROBLEM. SOHE VIEW THIS AS SIMPLY A SHORT-TERM, OR TECHNICAL PROBLEM; OTHERS, PERHAPS RECALLING THE FUNDING DIFFICULTIES OF THE SUMMER OF 1976, REGARD THE PROBLEM AS MORE PROFOUND. THE TIMES SUGGESTS THAT IN THE MEANTIME THE REVENUE LOST BY DIRECT TAX CUTS RESULTING FROM CONSERVATIVE AMENDMENTS TO THE FINANCE BILL SHOULD SOMEHOW BE CLAIMED BACK, POSSIBLY BY INCREASES IN EXCISE TAXES AND DUTIES.

10. GILT PRICES DRIFTED DOWNWARD THROUGH THE WEEK ONLY TO REIOVER SHARPLY ON WEDNESDAY. IT WAS BELIEVED THAT PRICES WERE CLOSE TO THOSE AT WHICH THE GOVERNMENT BROKER WWOULD SELL THE TAP STOCKS. MARKET SOURCES ATTRIBUTE THE IMPROVEMENT TO A RUMOUR THAT A BROAD FINANCIAL PACKAGE WAS IMMINENT, INCLUDING BOTH FISCAL AND MONETARY ELEMENTS. THE PROSPECT THAT FISCAL MEASURES MIGHT BE UNCLASSIFIED

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TAKEN, E.G., INCREASES IN INDIRECT TAXES, TO RECOUP REVENUES LOST THROUGH CONSERVATIVE AMENDMENTS TO THE FINANCE BILL, IS REPORTED TO HAVE ESPECIALLY ENCOURAGED THE MARKET AS A SIGN OF GOVERNMENT DETERMINATION TO DEFEND

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Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

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PAGE 01 LONDON 08999 04 OF 05 071803Z
ACTION EUR-12

INFO OCT-01 EA-12 IO-14 ISO-00 AID-05 CIAE-00 EB-08
FRB-01 INR-10 NSAE-00 ICA-20 XMB-04 OPIC-06 SP-02
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UNCLAS SECTION 04 OF 05 LONDON 08999

ITS FINANCIAL TARGETS.

11. ALTHOUGH GOVERNMENT EXPENDITURE APPEARS TO HAVE INCREASED AT THE END OF THE 1977/78 FINANCIAL YEAR, IT WAS NO MORE THAN EXPECTED. THE PUBLIC SECTOR BORROWING REQUIREMENT FOR 1977/78 WAS 133 MILLION POUNDS LESS THAN THE LEVEL ESTIMATED IN THE CHANCELLOR'S APRIL BUDGET, A DIFFERENCE LARGELY ATTRIBUTED TO AN ADJUSTMENT TO NATIONAL SAVINGS INTEREST PAYMENTS. THE QUARTERLY LEVELS OF THE PSBR FOR 1977/78, SEASONALLY ADJUSTED WERE:

(MILLIONS OF POUNDS)

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PAGE 02 LONDON 08999 04 OF 05 071803Z

1ST QUARTER 1,571
2ND QUARTER 926

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

3RD QUARTER 1,105
4TH QUARTER 1,974

12. EXCHANGE RATE AND GOLD

DATE	EXCHANGE RATE ($)	EFFECTIVE EXCHANGE RATE (DEC. 1971 EQUALS 100)	GOLD ($)
5/.31	1.8330	61.4	184-3/8
6/1	1.8265	61.4	183-3/8
6/2	1.8230	61.2	185-3/8
6/5	1.8205	61.1	182-5/8
6/6	1.8240	61.3	181-3/8
CHANGE 5/30-6/6	UP 0.0055	DOWN 0.1	DOWN 1-1/2

13. FORWARD PREMIUM ON STERLING

DATE	1 MONTH	3 MONTHS	6 MONTHS
5/31	- 0.35	- 1.10	- 2.20
6/1	- 0.35	- 1.15	- 2.35
6/2	- 0.42	- 1.30	- 2.65
6/5	- 0.45	- 1.50	- 2.97
6/6	- 0.48	- 1.47	- 3.05
CHANGE 5/30-6/6	DOWN 0.13	DOWN 0.35	DOWN 0.80

(ALL FIGURES IN CENTS)

14. EURODOLLAR INTEREST RATES

DATE	1 MONTH	3 MONTHS	6 MONTHS
5/31	7-1/2	8	8-3/8
6/1	7-13/16	8	8/1/2
6/2	7-3/4	8	8-1/2
6/5	8-1/8	8-1/8	8-1/2
6/6	7-3/4	8-1/8	8-1/2

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CHANGE 5/30-6/6 DOWN 1/4 DOWN 1/16 UNCHANGED

15. THREE-MONTH LONDON INTERBANK - EURODOLLAR INTEREST RATE DIFFERENTIAL

DATE	
5/31	1-7/16
6/1	1-19/32
6/2	1-11/16
6/5	1-5/8
6/6	1-3/4
CHANGE 5/30-6/6	UP 3/8

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Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

NNN

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PAGE 01 LONDON 08999 05 OF 05 071805Z
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UNCLAS SECTION 05 OF 05 LONDON 08999

16. STERLING CERTIFICATES OF DEPOSIT

DATE	1 MONTH	3 MONTHS	6 MONTHS
5/31	8-3/4	9-1/4	9-23/32
6/1	8-3/4	9-7/16	9-7/8
6/2	8-25/32	9-9/16	10-1/16
6/5	8-25/32	9-19/32	10-3/16
6/6	8-13/16	WOATXI	10-7/32

CHANGE 5/30-6/6 UNCHANGED UP WQQ 32 UP 19/32

17# INTERPOLATEE REEEMPTION YIELDS OF HIGH COUPON GOV-
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PAGE 02 LONDON 08999 05 OF 05 071805Z

ERNMENT SECURITIES

DATE	5 YEARS	15 YEARS	25 YEARS
5/31	11.52	12.76	13.18

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014

6/1 11.63 12.82 13.24
6/2 WQQMUT 12.91 13.32
6/5 11.92 13.01 13.43
6/6 11.88 12.98 13.39
CHANGE 5/30-6/6 UP 0.26 UP 0.17 UP 0.16

18. THE MINIMUM LENDING RATE REMAINED 9 PERCENT AS SET BY THE BANK OF ENGLAND.

19. THE TREASURY BILL RATE ROSE 0.2903 PERCENT TO 8.7728 PERCENT AT FRIDAY'S AUCTION AS THE 400 MILLION POUNDS IN BILLS TENDERED ATTRACTED 686.39 MILLION POUNDS IN BIDS. THIS WEEK 300 MILLION POUNDS IN BILLS WILL BE OFFERED AS THE SAME AMOUNT MATURES.

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Review Media Identifier:
Review Release Date: N/A
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2456954
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Subject: ECONOMIC DEVELOPMENTS FOR PERIOD JUNE 1 - 7 SUMMARY: THE ELIGIBLE LIABILITIES OF THE BANKING SECTOR INCREASED 1.4 PERCENT IN THE MAY BANKING MONTH. F
TAGS: ECON, UK
To: STATE TRSY MULTIPLE
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